
## Compliance Update - 06/22/2016

## Healthcare FSA Carryovers and COBRA Continuation

It used to be simple to determine the amount of a qualified beneficiary's benefit available and the COBRA premium required for a Healthcare Flexible Spending Account (FSA). However, starting in 2013, Healthcare FSAs allowed a carryover of up to $500 of unused funds from one plan year to the following year (see Landmark Notice Allows Carryover of Unused Funds). And, although COBRA does not apply to all Healthcare FSAs (see Affordable Care Act Changes for Flexible Spending Accounts for healthcare FSA "footprint" rule), many Healthcare FSAs are subject to COBRA continuation of some duration upon a qualifying event.

Internal Revenue Service (IRS) Notice 2015-87, released December 16, 2015, takes the mystery out of offering COBRA continuation for Healthcare FSAs that include carryover amounts. This is the third of three Compliance Alerts we are issuing on topics addressed in the Notice.

**Background**
Healthcare FSAs are considered group health plans and are subject to COBRA. However, a special limited COBRA responsibility may apply for employees who have "overspent" their accounts.

For employees who have not overspent their account, the limited COBRA coverage stops at the end of the plan year in which COBRA was first offered. If the Healthcare FSA does not meet all the requirements to offer limited COBRA coverage then COBRA continuation must still be offered, but coverage would continue for 18 months or longer, depending on the qualifying event.

**COBRA and Carryover**
In order to calculate COBRA eligibility and premiums, employers need to determine two things:

- What is the maximum benefit employees are entitled to receive for the remainder of the year as a benefit under the Healthcare FSA? The remaining balance in their account as the day before the qualifying COBRA event, including carryover amounts; and
- What is the cost of the premium needed to pay for COBRA continuation? The maximum amount required to be paid for COBRA does not include the unused amount carried over from prior years. This carryover amount is not part of the salary redirection for the current year. The applicable premium is based solely on the sum of the employee's salary reduction election for the year and any non-elective (employer) contributions.

Let's look at an example of each requirement.

- Maximum benefit. Employee elects $2,500 for the current plan year and has $500 carried over from the previous plan year. In addition, she has been reimbursed $1,100 as of the day prior to her termination of employment on July 1. The maximum benefit she is entitled to receive for the remainder of the plan year under the Healthcare FSA, including the amounts carried over, is $1,900. (($2,500 + $500) - $1,100).
- COBRA premium. The maximum premium required for COBRA (that is, 102 percent of the applicable premium) does not include amounts carried over from previous plan years. The premium amount is $238 per month for the remaining six months of the plan year. (($2,500 - $1,100 / 6) X 1.02).

**COBRA Continuation into New Plan Year**

Healthcare FSAs are not required to allow COBRA beneficiaries to elect additional amounts at the beginning of a new plan year or access to any employer contributions, following the plan year of COBRA eligibility. However, any funds (up to $500) remaining at the end of the plan year, are carried over to the new plan year for an active COBRA beneficiary as of the last day of the qualifying-event plan year. The applicable premium for carryover funds for the new plan year is zero. The carryover is also limited to the appropriate, generally 18 month, COBRA continuation period. That could span more than one open enrollment for beneficiaries.

Example: During the Healthcare FSA plan year an employee experiences a qualifying event as of June 1, 2016, elects COBRA continuation, and pays the required premiums for the rest of the plan year. At the end of the plan year, there is $500 of unused benefits remaining.

The beneficiary can continue to submit expenses under the same terms as similarly situated non-COBRA beneficiaries in the next plan year, up to $500. The premium for the carryover during the new plan year is zero; however, the available coverage period is 18 months and terminates at the end of November 2017. COBRA coverage ends and the Healthcare FSA need not reimburse any expenses incurred after that date.

**Carryover Flexibility**

Offering the carryover of unused Healthcare FSA funds is at the employer's option; but is quickly becoming a standard feature for Healthcare FSAs. For the overwhelming majority of employers who offer the carryover provision, Notice 2015-87 allows some flexibility in features of carryover provisions.

A Healthcare FSA may limit the availability of the carryover of unused amounts (subject to the $500 limit) to individuals who elect to participate in the Healthcare FSA in the next year. Employers may even set a minimum amount of salary reduction elections to the Healthcare FSA for the next year. For example, employers can condition the carryover of funds to employees electing at least $60 or more to the Healthcare FSA. Therefore, only employees electing $60 or more for new plan years have their remaining funds (up to $500) carried over to the new plan year. Employees not electing the Healthcare FSA would forfeit leftover funds as of the end of the plan year.

A Healthcare FSA may also limit the timeframe that unused amounts may be used. For example, a Healthcare FSA can limit the ability to carry over unused amounts to one year. If a participant carried over $30 and did not elect any additional amounts for the next year, the Healthcare FSA may require forfeiture of any amount remaining at the end of that next year.

One final point - The Healthcare FSA “footprint,” rule (as discussed in our Alert Affordable Care Act Changes for Flexible Spending Accounts), has long been misunderstood and must be followed because of the Affordable Care Act market reform. When Healthcare FSAs were overspent and employees did not have the offer of other group health coverage, some employers didn’t offer limited COBRA - ignoring the footprint rule. Employers need to “clean house” and assure that internal processes and procedures support current legislation.

Remember, certain COBRA events require both spouses and dependents be considered COBRA beneficiaries. Decide now if you have the information and processes in place to determine COBRA benefits, premiums, and how to distribute beneficiary notifications.

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**Thank you,**

**Your Team at WageWorks**



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